MEDIUM-TERM PUBLIC DEBT MANAGEMENT STRATEGY 2023-2025

REPUBLIC OF CYPRUS
MINISTRY OF FINANCE
PUBLIC DEBT MANAGEMENT OFFICE

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Public Debt Management Office
Michael Karaoli & Gregori Afxentiou str.
Ministry of Finance
1439 Nicosia - Cyprus

Tel. +357 22 601265, 22 601182 / Fax: +357 22 602749
www.mof.gov.cy/pdmo

This document has been prepared based on data available up to 30 September 2022.

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I. Introduction

A strong public debt management strategy constitutes a basic element of sound fiscal management. Following the Covid-19 crisis which presented a big challenge for sovereign debt managers, the recent Russia-Ukraine war and the EU sanctions effects combined with the inflationary pressures have increased the uncertainty in the global economy. The Russia-Ukraine wars has highly impacted energy and food markets leading the European Union to coordinate their actions to tackle rising prices and scarcity of supplies. As a result of high inflation, the European Central Bank (ECB) decided to raise ECB rates to tackle soaring inflation and ensure the timely return of inflation to the ECB's 2 percent medium-term target. Therefore, the bond yields have started to move at higher levels leading the issuers of new bonds to offer higher yields to attract investors. Despite the challenges stemming from the new interest rate environment in 2022, through the implementation of the current Medium-Term Debt Management Strategy (MTDS) 2022-2024, the majority of the targets set under the said strategy has been achieved at a very satisfactory level. The objective of funding the majority of gross financing needs through international markets access has been satisfied increasing the visibility of the EMTN issued by the Republic of Cyprus in the international markets and attaining a relatively low coupon rate (0.95%) due to the decision of the PDMO to access the market early, in the beginning of the year 2022. In the context of the target of a portfolio with low risk at a reasonable cost, the basic strategy followed in the previous year, will be continued during the period 2023-2025 with the main targets being the continuation of what has been achieved, taking into consideration new conditions that have been recently created.

Pursuant to the selected strategy, the fixed rate EMTN remains the most realistic option and is therefore considered to be the optimal tool to achieve the best possible outcome under an acceptable cost-risk level. However, due to the new interest rate environment, the borrowing from the international capital markets is expected to be realized within the maturity spectrum of 10 to 20 years. Assuming normal market conditions, the financing operations will be implemented within a framework consisting of three pillars:

(i) Refinancing risk: The main objective of the Public Debt Management Office (PDMO) is to maintain a balanced debt maturity profile with manageable gross financing needs as a percentage of GDP. In addition, in order to reduce both the interest rate risk and the exchange rate risk due to the exchange rate variations, the majority of the new loans will be primarily in the form of fixed interest rates and in euro. The cash buffer will continue to be maintained at a level that meets the gross financing needs throughout the year, as defined in the MTDS 2023-2025 and the relevant decisions of the Council of Ministers.

(ii) Development of the government securities market: The stock of government securities will continue to grow in the following years through the international bonds issuances since they will replace debt maturing in different types such as loans. The development of the government securities market will continue to be a strategic objective for the next three years, focusing on two sub-objectives: (a) In the primary market, a benchmark bond issue on a regular basis, at least one issuance per year, through the EMTN program will be targeted and (b) In the secondary market, the enhancement of the pricing mechanism, the transparency and the liquidity of the Cyprus bond markets will be targeted through the operation of the international bank group which was appointed by the Republic of Cyprus.

(iii) Development of investor relations: The PDMO will continue its efforts to maintain contacts with existing investors and find new investors in order to extent the investor base and diversify it geographically. The overall objective will be to further extend the demand for Cyprus government securities to more and less correlated investors.

The above guidelines are interrelated, and a single action can contribute to the satisfaction of multiple guidelines at the same time. In conclusion, the above pillars are expected to contribute positively to the minimization of the debt portfolio cost and the containment of financial risks.

In addition to the broader guidelines, quantitative benchmark targets are set in order to concretize the cost-risk appetite. It is noted that, space is allowed for flexibility in order to facilitate the response to unusual market conditions or adverse economic events.

The second chapter that follows, analyzes the institutional framework of the MTDS and the objectives of the strategy. The third chapter presents the macroeconomic-fiscal developments and the risk factors for the economy.

In the fourth chapter, the financing needs of the State for the period 2023-2025 and the main borrowing tools are presented. The fifth chapter illustrates the review of the implementation of MTDS 2022-2024 and the sixth chapter presents the strategic framework of the new strategy 2023-2025.

Finally, in the seventh chapter, the final provisions related to the proposed strategy 2023-2025 are described.

II. Legal Framework and objectives

A. Legal and Institutional framework

Pursuant to paragraph 1 of Article 9 of the Public Debt Management (PDM) Laws of 2012 to 2016, the MTDS, which covers a time horizon of three to five years, is prepared and revised at least once a year on a rolling basis by the PDMO.

Pursuant to paragraph 2 of Article 9 of the PDM Laws of 2012 to 2016, the strategy and its updates are submitted by the Minister of Finance to the Council of Ministers after informing the 'Finance and Budget' Committee of the House of Representatives for approval. The said Committee is given a deadline no later than the end of October of the year preceding the launch of the strategy. After final approval, borrowing and other operational functions are planned based on the strategy. The actions for each calendar year constitute an integral part of the Annual Funding Plan (AFP) which should, as far as possible, be consistent with the MTDS.

The PDMO was established under the same Law of 2012 within the Ministry of Finance with its main responsibilities being:

(i) the execution of public debt management operations,
(ii) the management of government cash reserves,
(iii) lending transaction risk assessment and
(iv) the preparation of any legislation regarding the regulation of public debt management operations.

B. Ultimate objective of public debt management and the scope of strategy

The ultimate objective of public debt management is to ensure that financing needs are always met in time and that the cost of borrowing is the lowest possible in the medium term, within the framework of an acceptable level of financial risk.

The analysis covers the Central Government debt which comprises almost 100% of the debt of the General Government. In terms of the range of financing needs analyzed, sources of risk, such as government guarantees, or potential revenues, are included in the strategy only to the extent that they are incorporated in the budget forecasts.

The MTDS 2023-2025 is a policy paper, describing the direction and actions of public debt management during this period. The design of the new strategy was based on the existing strategy, with its basic guidelines remaining the same.

The objective of the strategy is dual:

- the definition and explanation of the strategic pillars for the State financing actions and the continuation of the development of the Cypriot bond market,

- the implementation of a framework with quantitative and qualitative objectives in order to implement the strategy pillars.

In addition, the existing cost-risk ratio of the portfolio, the new environment on the bond market and the macroeconomic framework were considered in the design of the strategy.

III. Basic macroeconomic assumptions and risk factors

The strong growth rate of the economy in 2021 of 5.5% of GDP in real terms seems to be continue in 2022 despite the ongoing Russia-Ukraine military conflict. In 2022 the growth rate of the economy is projected at 5.7% of GDP. The positive GDP growth rate is mainly due to the improved economic activity in most sectors of the economy, namely in “Hotels and Restaurants”, “Transport, Storage and Communications”, “Wholesale and Retail Trade, Repair of Motor Vehicles”, “Arts, Entertainment and Recreation” and “Other Service Activities”.

The economy is projected to recover further with the growth rate approaching 3.0% in 2023, 3.3% in 2024 and in the medium term at 3.2% in 2025, a percentage close to the potential growth rate of the Cyprus economy.

Even though the forecasts are positive, there are various risks which are related to internal and external environment such as:

1. the possibility of a new wave or mutations of the Covid-19 pandemic;
2. geopolitical factors;
3. deteriorating business and consumer confidence;
4. the high percentage of non-performing exposures;
5. any prolonged prevalence of strong inflationary pressures;
6. the continuation of the Russia-Ukraine crisis and the EU sanctions effects;
7. the global climate change.

Consumption and investments will continue to contribute positively to the growth rate of the Cyprus economy. The largest drivers to growth are expected to remain the Retail, Tourism, Professional Services - mainly Financial, Shipping and IT services - and the Construction sector. Despite the loss of Russian tourists due to EU sanctions against Russia, the Tourism sector has performed better than expected in the first eight months of 2022, however is not projected to recover and fully return to the levels of previous years before 2024, nevertheless, its impact will be significant in the medium term.

In 2022 Cyprus submitted a formal request for a second top up temporary support to mitigate Unemployment Risks in an Emergency (SURE) of the order of EUR 29 mn increasing the borrowing under the said instrument to EUR 632 mn. The additional amount which is expected to be disbursed during the last quarter of 2022 correspond to the fiscal cost of relevant measures that continue to be implemented by the Government of Cyprus. Furthermore, the gradual implementation of the National Recovery and Resilience Plan of a total amount of EUR 1.2 bn which is subject to the achievement of specific milestones and policy targets, is expected to have a positive impact on the growth profile and the diversification of the Cyprus economy from 2022 onwards. An amount of EUR 26 mn in loans has already been disbursed in September 2021 whilst an amount of EUR 170 mn in grants is expected to be disbursed within the year 2022.

Inflation (CPI) is estimated to follow upward path reaching 7.7% in 2022 compared to 4.8% in 2021, mainly driven by supply price pressures, especially on energy prices as a result of the Russian-Ukraine war. In 2023 it is forecast to reach 3.0% and hover around 2.0% in 2024 and 2025. Unemployment is expected to average at 7.0% in 2022 and then is projected to gradually decline to 6.4% in 2023, 5.7 in 2024 and 5.0% in 2025.

The fiscal balance of the General Government is projected to turned to surplus in 2022, reaching a surplus of 1.2% of GDP compared to a deficit of 1.7% of GDP the year before, despite the negative impact of the Russia – Ukraine war launched in February 2022. This is mainly attributed to the improvement of the economic environment. For the coming years, the fiscal balance is projected to improve further reaching 1.7% of GDP in 2023 and then is projected to be stabilize at 2.3% of GDP in 2024 and 2025.

Government debt is projected to drop significantly by 14.3 percentage points of GDP in 2022 and reach 89.3% of GDP in 2022 from 103.6% in 2021. In 2023 it is projected that the debt-to-GDP ratio will continue its downward trend falling to 83.3%, and decreasing further to 76.5 and 72.3% of GDP in 2024 and 2025, respectively. It is worth noting that, at the end of 2022, cash reserves are projected to account for around 9% of GDP. The percentage will meet the target of the MTDS to cover the financing needs of the next 6-9 months.

The measures taken both at national and European level about the pandemic, have contributed to the recovery of the domestic banking sector, maintaining its capital and liquidity position. The increase in provisions of new lending has facilitated the recovery of the economy.

In the first half of 2022, the CET1 capital ratio stood at 17.5% as was at the beginning of the year. The solvency ratio remained stable from 20.5% at the beginning of the year to 20.6% in June 2022.

The asset quality has continued to improve with the NPL ratio declining further from 17.6% in June 2021 to 11.2% in June 2022. Specifically, the reduction in non-performing exposures (NPEs) continued, as NPEs dropped from €9.1 bn on 31st of December 2019 (28.0% of gross loans) to €2.9 bn on 30th of June 2022 (11.2% of gross loans), accumulated provisions being 51.0% of NPEs, and restructurings €3.3bn (12.5% of gross loans). Banks continue their deleveraging efforts, with further significant sales of NPEs portfolios expected to be completed and accounted for within the next periods. In addition, new lending has exceeded the levels of previous years with the solid liquidity and solvency position of the Banks allowing them to support the domestic economy, with stricter lending criteria being in place.

Profitability has been improved within the first half of the year 2022 with enhance return on equity that compares well with the EU average. The structural weaknesses in the Cypriot banking system such as inflexible labour cost and the limited business model have affected the profitability. Notwithstanding this, spillover risks from the banking sector to the sovereign are assessed as low.

IV. Financing needs and funding sources

A. Financing Needs

The strategy period 2023-2025 is characterized by manageable financing needs, despite the impact of the Russia-Ukraine war and other external shocks, including a new wave of the Covid-19 pandemic, on public finances. The years 2023-2025 are characterized by low to moderate gross financing needs, with the fiscal surplus to be estimated to follow an upward path in the reference period. In addition, in relation to the size of the economy, gross financing needs will range between 3.6% and 6.4% of GDP over the three-year period.

Table 1: Central government gross financing needs

In bn EUR	**2023**	**2024**	**2025**
	in EUR bn		
Long term debt redemptions	1.4	2.4	1.8
Fiscal deficit/(surplus)[1/]	(0.4)	(0.5)	(0.6)
Gross financing needs	**1.0**	**1.9**	**1.2**

1/= The fiscal balance projections are based on the data available up to date and may differ in view of the high level of uncertainty surrounding the effects of the Russia-Ukraine war, EU sanctions effects and other external shocks including a new wave of the Covid-19 pandemic.

B. Financing Sources and Instruments

The European Medium-Term Bonds (EMTN) will continue to be the main source of borrowing to meet the government's financing needs according to the MTDS 2023-2025 for strategic reasons since issuers can attract investors beyond the domestic market through the international market, thus expanding the investment base in size, geographically and by category. In addition, issuers usually achieve lower borrowing cost through external sources. It is noted that these bonds are issued through the Euro Medium Term Note Program, are governed by English law and are listed on the London Stock Exchange. The bond clearing is performed through the Euroclear / Clearstream repositories.

The domestic market will continue to be used as a supplementary source of funding to meet the State's financing needs. For the reporting period, priority will be given to the issuance of retail bonds to individuals for a period of 6 years on a quarterly basis, a financial tool available to cover the special characteristics of individuals as investors.

Treasury Bills remain the main short-term financial instrument, which are aimed at improving the management of government cash reserves and at reducing the weighted average cost of government debt. As for the European Commercial Papers Program, although it can be used as an alternative source of financing in the short term by attracting funds from abroad, it remains inactive since the end of 2014, although it is not ruled out that it can be used again in the near future.

Another financing tool that can be adopted by the Government, is the borrowing from supranational organisations either for new projects or for the continuation of ongoing infrastructure projects, which combine low borrowing costs and long repayment periods. Furthermore, a new financing tool which combines loans and grants has been launched since 2020 either for temporary Support to mitigate Unemployment Risks in an Emergency due to the pandemic of Covid -19 or for Next Generation EU in order to repair, restart, and reconfigure Cyprus' economic and social composition and positively impact the quality of human capital and labour force as well as to improve the efficiency of its institutions and to achieve the green and digital transition of Cyprus.

C. Potential Funding Sources

This sub-section provides a brief overview of the government's potential funding sources and the cost and risks associated with various financing sources. The available funding is being provided either through marketable and non-marketable borrowing instruments. Table 2 exbibits the cost and risk characteristics of the potential marketable and non-marketable borrowing instruments of Cyprus.

The Government has to meet its gross financing needs either from external or domestic sources, considering the government's cost and risk level of tolerance. Given that domestic funding is limited, the focus of the Government is to finance its gross financing needs mainly through external funding. It is noted that external funding will continue to be, de facto, the government's preferred financing source in the near future as the said financing has the necessary funds and it is cost effective and long-term. A target has been set underlining that at least 60% of the gross financing needs for the period 2023-2025 will be covered by external sources, of which the majority will be through EMTN issuances in the international market.

Table 3: Characteristics of potential borrowing instruments

Market instruments					
Security	**Maturity**	**Interest rate type**	**Governing Law**	**Investors Base**	**Benefits and potential risks**
Treasury Bills	Up to 12 months	Zero coupon	Cyprus law	Domestic Monetary Financial Institutions	**Benefit**: lower cost compared to other domestic financing instruments, facilitate the development of the domestic capital market **Risk**: higher refinancing risk
Euro Commercial Papers	Up to 12 months	Zero coupon	English law	International and /or institutional foreign investors	**Benefit**: lower cost compared to other domestic financing instruments and access to international investors **Risk**: higher refinancing risk
Domestic Retail Bonds	6 years	Step-up structure	Cyprus law	Domestic natural persons	**Benefit**: help diversify funding sources for the Government, facilitate the development of the domestic capital market **Risk**: higher refinancing risk, higher cost.
Domestic Bonds	Beyond 12 months	Fixed only	Cyprus law	Mainly domestic banks, Insurance Companies, Provident Funds and small domestic institutional investors	**Benefit**: Facilitate the development of the domestic capital market **Risk**: Higher interest cost, limited available financing
Euro Medium Term Notes (EMTNs)	Beyond 12 months	Fixed only	English law	Foreign and domestic institutional investors	**Benefit**: Strong available financing, higher flexibility in terms of currency-maturity, diversity (larger pool of investors) **Risk**: principal documents are required (offering circular, program agreement, legal opinions e.t.c). Any negative developments not correlated to the Cypriot economy.
Non-market instruments					
Type	**Maturity**	**Interest rate type**	**Governing Law**	**Creditors**	
Foreign Loans	Typically more than 10 years	Fixed or variable	European law	European Investment Bank, Council of Europe Development Bank, EE, Domestic market	**Benefit**: highly concessional loans; lowers financing cost; grace period, long-term maturity. **Risk**: Fluctuations of interest, exchange risk in case of foreign currency borrowing

V. Review of the implementation of MTDS 2022-2024

This section focuses on the overview of public debt management and the events that affected the current Public Debt Management Strategy 2022-2024 objectives, which was approved by the Council of Ministers and published in October 2021.

A. Review of debt management operations

Despite the high degree of uncertainty in the global economy as a result, among other factors, the continuation of the Russia-Ukraine crisis, the EU sanctions effects, the inflationary pressures as well as the possibility of a new wave of the Covid-19 pandemic, the PDMO, after the approval of the Minister of Finance, revised the Annual Funding Plan in May 2022 (see attached I) by decreasing the maximum borrowing limit set in the initial Annual Funding Plan. This outcome was attributed to the better-than-expected fiscal performance in 2021 as well as to the continuation of the strong growth rate of the Cypriot economy during the year 2022. Specifically, the maximum borrowing limit has reduced by around EUR 0.4 bn leading to higher utilization of cash buffer accumulated in the previous years to cover the gross financing needs of the year 2022. The government's budgetary position which was into a budget deficit of about -1.7% and a primary balance of about 0.2% in 2021, has recorded an improvement compared to the year before. This led to a significant decrease of public debt by around 11 percentage points (p.p.) by the end of 2021, reaching 103.6% of GDP compared to 115% of GDP in 2020. However, about 11.8% of the public debt as a % of GDP represents cash buffer.

In January 2022, PDMO came to market by issuing a new 10-year bond (EMTN) of the order of €1,0 bn, taking advantage of the favorable conditions prevailing in international markets. A yield of 0.994% and a coupon of 0.95% were achieved. The transaction was aimed, among other things, at boosting government cash reserves given the pending repayment of an EMTN of the order of €1.0 bn in May 2022.

The better-than-expected fiscal performance last year combined with the continuation of the improvement of the government's fiscal position in 2022, contributed to the mitigation of the fiscal consequences due to the war in Ukraine. Cyprus's economy has proven resilient to recent external shocks and as mentioned above, the PDMO decided to revised the initial Annual Funding Plan by reducing the maximum borrowing limit.

In the period May-June 2022, an additional amount of the order of EUR 100 mn was disbursed by European Investment Bank for the implementation of either new projects or ongoing infrastructure projects. During the last quarter of the year, Cyprus is expected to receive an amount of the order of EUR 170 mn in grants from the Recovery and Resilience Fund as well as a second top-up support under SURE instrument of the order of EUR 29.2 mn which corresponds to the fiscal cost of relevant measures that continue to be implemented by the Government of Cyprus.

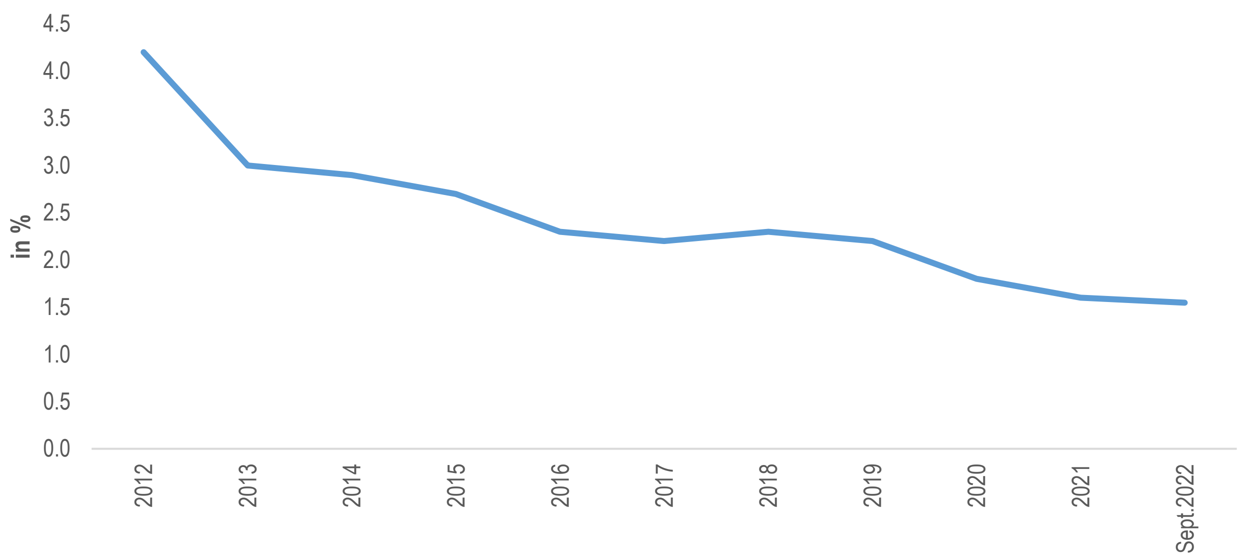
In summary, the total financing for the period January – September 2022, excluding the roll-over debt, amounted to approximately €1120 mm, of which €1000 mn was raised through the international bond market.

B. Cost Outcome

B1: Cost of the debt portfolio

The weighted average debt portfolio cost, as shown in Figure 1 below, is on a downward trend approaching 1.5% at the end of September 2022 compared to 1.6% in 2021 and 4.2% in 2012. The downward trend of the weighted average cost of public debt is reflected in the reduction of interest paid by the Republic of Cyprus. The main reasons for the reduction of public debt service are the improvement of the credit rating of the Republic of Cyprus, the environment of low interest rates in the European market during the last years, a number of liability management transactions executed in the previous years and the new low-cost issues replacing existing debt carrying a higher interest rate. However, we expect that the cost of the public debt will go up in the following years after the consecutive hikes in interest rates by the European Central Bank to tackle the extremely high inflation in the economy.

Figure 1: Weighted average cost of public debt



(Source: PDMO)

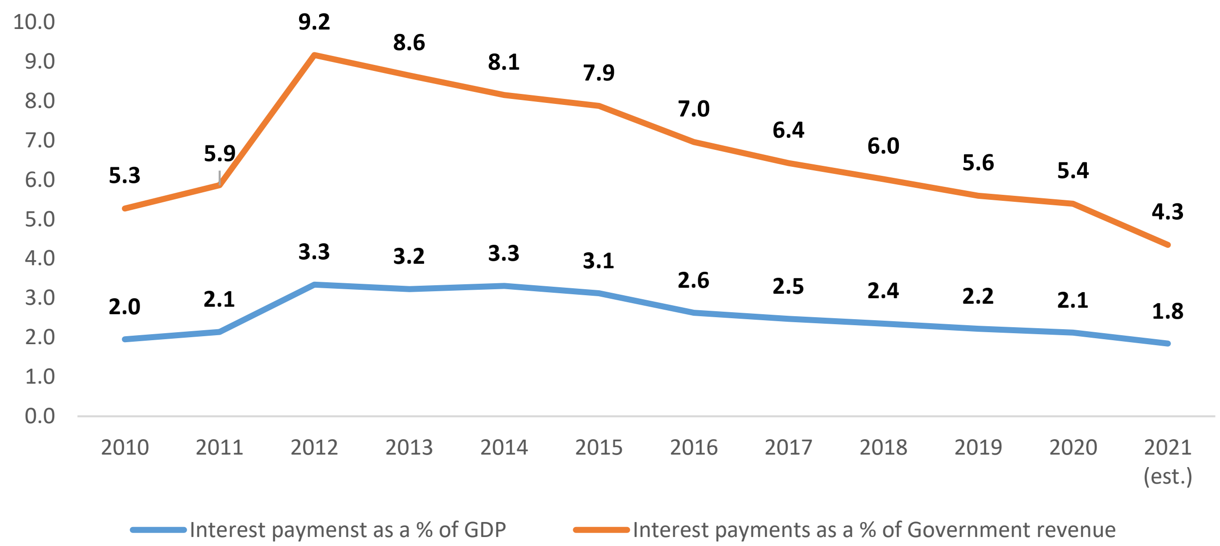
B2: Debt affordability

Interest paid as a percentage of GDP and government revenue, which are considered as key indicators of public debt sustainability, have been declining since 2013, as shown in Figure 2 below.

The improvement is mainly attributed to the new low-cost issues replacing existing debt carrying a higher interest rate as well as to the improvement of the economic activity leading to higher revenue and GDP.

Interest payments as a share of government revenue declined from 9.2% in 2012 to 4.3% in 2021 and interest as a percentage of GDP declined from 3.3% in 2012 to 1.8% in 2021. By the end of 2022, a further improvement is expected due to the reduction of interest in absolute numbers (numerator effect) and the increase of GPD (denominator effect).

Figure 2: Share of interest to GDP and government revenue



(Source: PDMO)

C. Risk Indicators Outcome

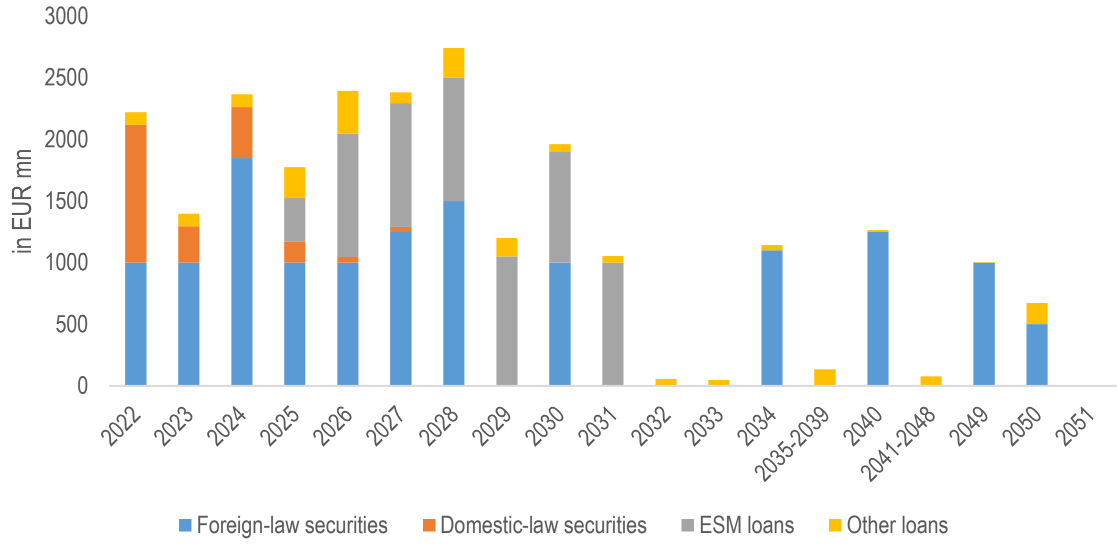
C1: Refinancing risk

Debt settlement smoothing and lengthening the average remaining debt maturity were at the epicenter of debt management activities. The results were apparent in all indicators reflecting the refinancing risk. Figures 3 and 4 show the repayment schedule at the end of 2021 and at the end of September 2022.

The new points of debt which were added in the debt maturity profile as at the end of September 2022 are in years 2032, 2037 and 2042 due to the EMTN issuance and loans disbursed from the European Investment Bank as well as in year 2028 as a result of retail bonds issued during the current year.

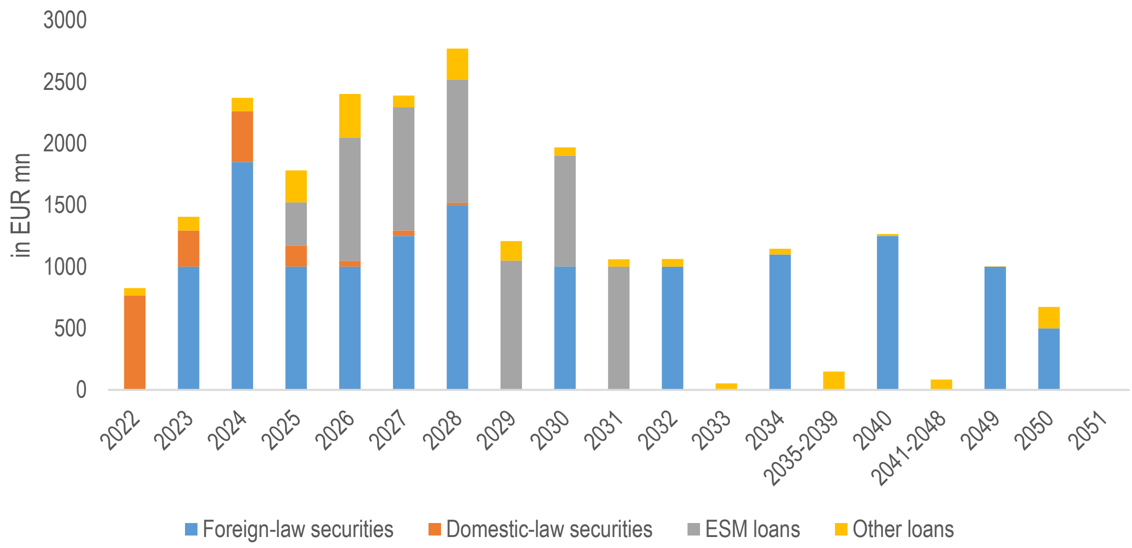
Despite the spike in public debt in year 2028, in general, the debt maturity profile in 2022 remained within comfortable/manageable levels, reducing the refinancing risk of the Government. The borrowing plan of the Government in 2022 has moved at lower levels compared to 2021 as a result of the better-than-expected fiscal performance last year which led to less utilization of cash buffer accumulated in the previous years as well as to the continuation of the strong growth rate in 2022.

Figure 3: Public debt maturity profile, at the end of 2021



(Source: PDMO)

Figure 4: Public debt maturity profile, at the end of September 2022



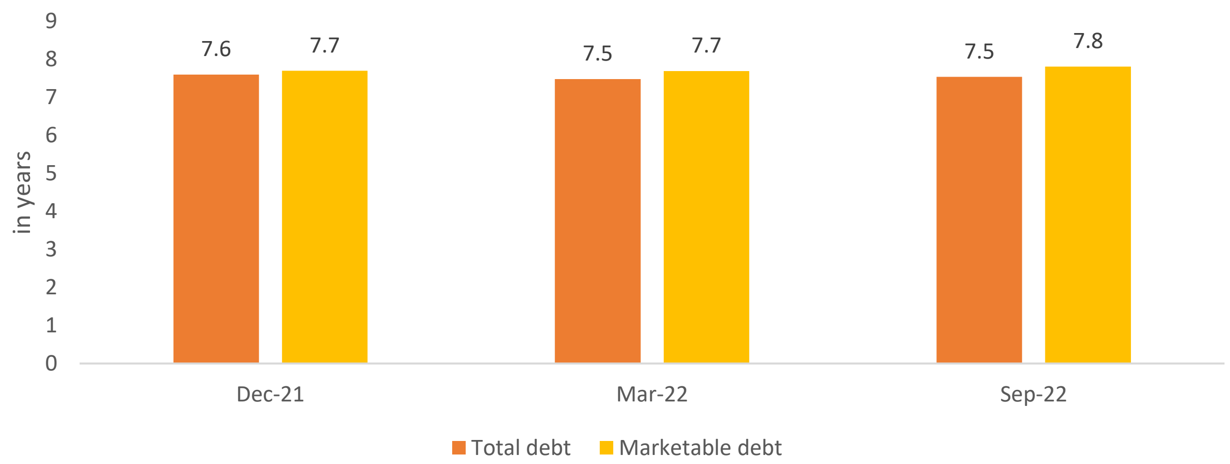
(Source: PDMO)

Other commonly used indicators for refinancing risk are the average remaining maturity of marketable debt and the ratio of debt maturing within one year and five years. Figure 5 and 6 below show these indicators at the end of March and September 2022 compared to the end of 2021.

The average remaining maturity of marketable debt recorded a minor increase in 2022 approaching 7.8 years at the end of September 2022 compared to 7.7 years at the end of 2021 as a result of the reduction of public debt (denominator effect). The corresponding total debt ratio has recorded a minor decrease compared to the year 2021 reaching 7.5 years by the end of September 2022. However, the said indicators compare very well in relation to euro area average and are well above the target set in the MTDS.

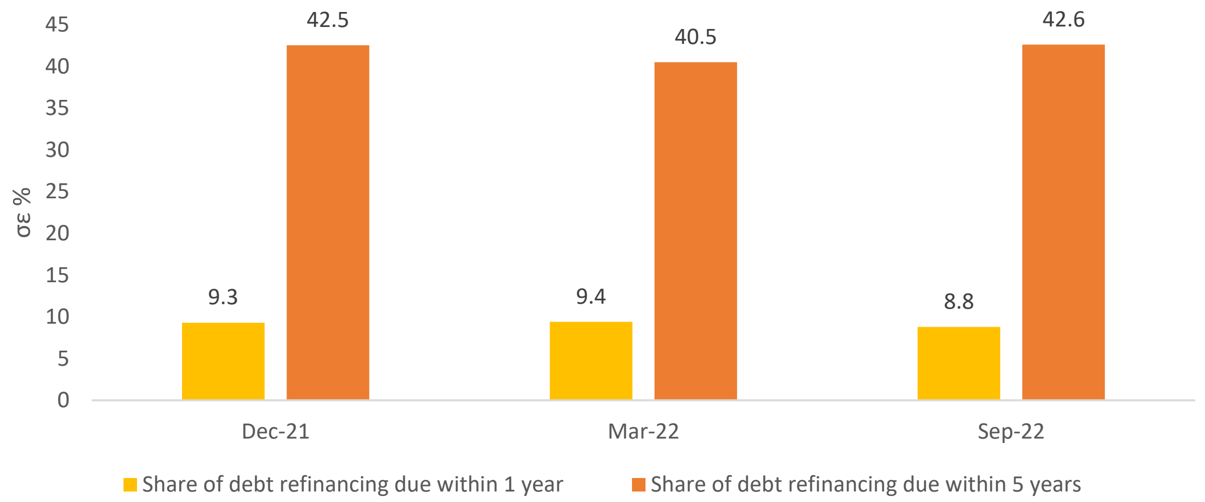
The ratio of debt maturing within one year recorded a reduction reaching 8.8 percent in September 2022 compared to December 2021, whilst the ratio of debt maturing within five years has stabilized at 42.6 percent by the end of September 2022.

Figure 5: Average remaining maturity of debt



(Source: PDMO)

Figure 6: Share of debt due within one-year and five-year

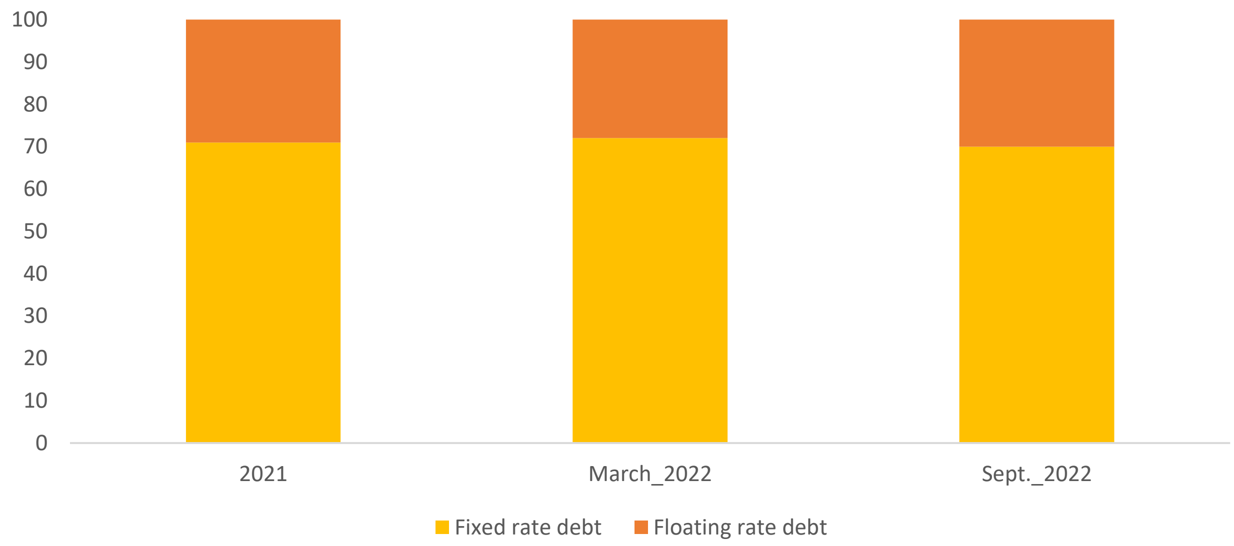


(Source: PDMO)

C2: Interest rate risk

The share of debt with floating interest rate against total debt followed a downward path in the first quarter of 2022 as shown in the Figure below. Then, the floating rate debt has marked a minor increase due to the reduction of the outstanding amount of total debt and specifically due to the reduction of the outstanding amount of 13-week T-bills and retail bonds during the year (denominator effect). However, the floating rate debt is expected to be maintained at similar levels in the following years, and from 2025 onwards the said debt is expected to follow a downward path as a result of the repayment of the ESM loans which carry floating interest rates. The reduction of the floating rate debt will continue to be a priority in the new MTDS 2023-2025.

Figure 7: Share of floating-rate debt against total debt

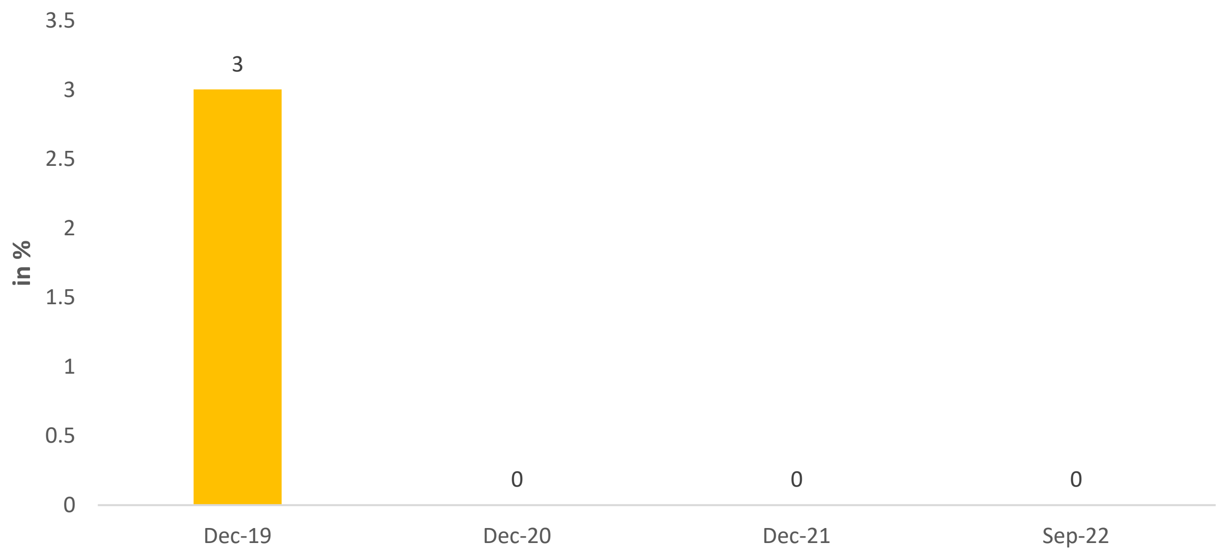


(Source: PDMO)

C3: Currency risk

Figure 8 below illustrates the evolution of foreign currency debt against total debt, which has been zero since March 2020 after the early repayment of the IMF loan, eliminating both foreign exchange and interest rate risk. It is noteworthy that the outstanding debt to the IMF at the end of 2019 was approximately €704 million and two months later when it was repaid, it amounted to €717 million, reflecting the risk of exchange rate fluctuations.

Figure 8: Share of foreign-currency debt against total debt



(Source: PDMO)

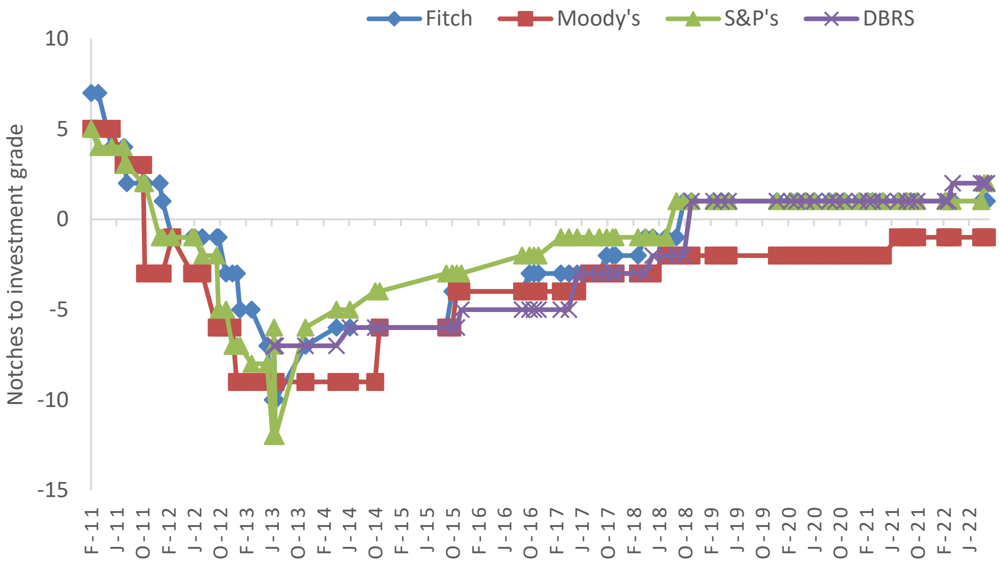
C4: Liquidity Risk

The MTDS objective of maintaining cash reserves to meet the financing needs of the next 6-9 months, has been met throughout 2022 with cash reserves at the end of September 2022 exceed the financing needs of the next 9 months. As a result of the cash strong position of the Government, the liquidity risk is very low.

D. Evolution of credit rating, credit spreads and investor base

The credit rating of the long-term debt of the Republic of Cyprus was maintained in the investment category by three Credit Rating Agencies in 2022, whilst two of them proceeded with an upgrade of the credit rating by one notch changing the outlook from positive to stable. Specifically, DBRS and S&P's upgraded the long-term sovereign rating of Cyprus to BBB from BBB (low) and BBB- respectively whilst Fitch affirmed the Cyprus's long-term issuer default rating at the lower medium grade of the investment category with stable outlook. Moody's affirmed the Cyprus's long-term issuer default rating at Ba1 and changed the outlook from stable to positive in 2022. Figure 9 below shows the historical development of the ratings of the Republic of Cyprus during the period 2011-2022.

Figure 9: Long-term credit rating of the Republic of Cyprus 2011-2022



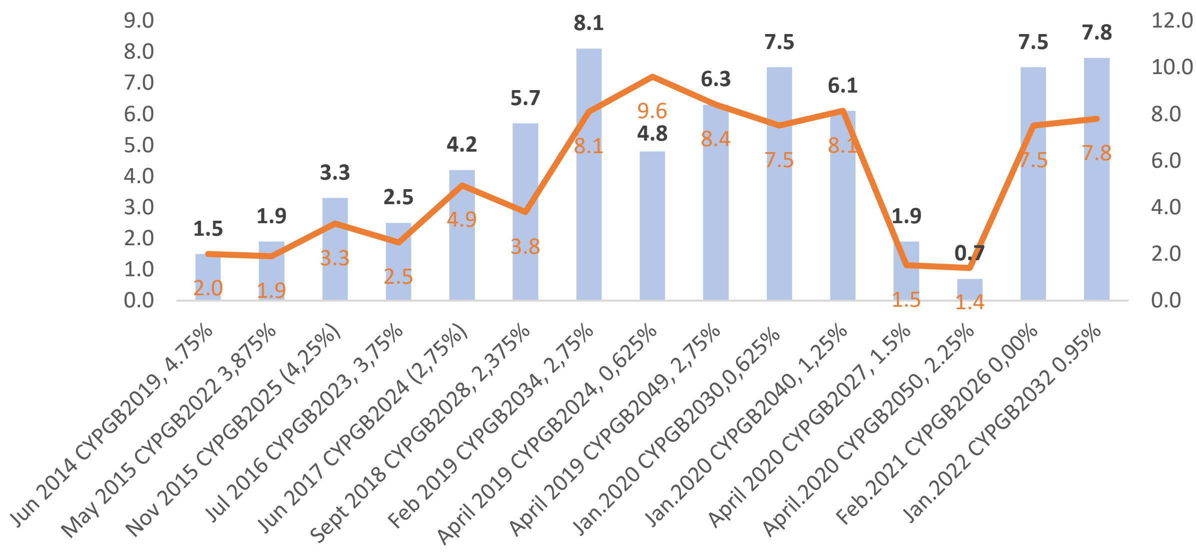
(Source: PDMO)

The improvement of the credit rating of the Republic of Cyprus in recent years and the fact that three of the rating Agencies affirmed the Cyprus's long-term issuer default rating for five consecutive years and two of them upgraded the long-term issuer default rating by one notch this year and one of them changed the outlook from stable to positive were, amongst others, factors that facilitate the market access of Cyprus to international markets, enrich and improve the bonds yield curve and reduce government financing costs or constrain the cost of borrowing at lower levels.

Figure 10 below shows the historical evolution of the order book in conjunction with the investor coverage ratio for the EMTN issued by the Republic of Cyprus for the period 2014-2022. As shown in the Figure below, the coverage ratio of bond issues is at a very satisfactory level, mainly as of the year 2018, reflecting the great interest of investors to participate in the bond issues of the Republic of Cyprus. In January 2022, the total order book for the EMTN issuance reached EUR 7.5 bn and the investor coverage ratio stood at 7.5 times despite the fact that the said issuance was priced with the lowest reoffer yield and lowest coupon (0.0%) that has ever been achieved by the Republic of Cyprus since its return to the markets.

An exception is the month of April 2020, during which the bond coverage ratio recorded a significant decrease. This is an isolated case and is due to the great uncertainty that preceded the first wave of the pandemic and the waiting for EU decisions to address the economic impact of the Covid-19 pandemic.

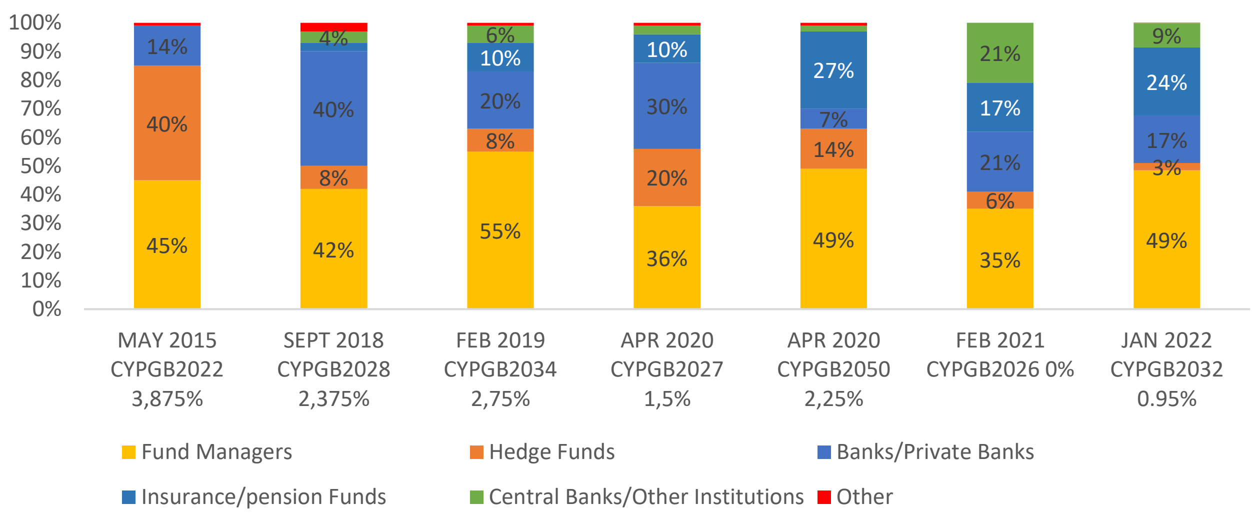
Figure 10: Orderbook size



(Source: PDMO)

The distribution of investors by type shows a significant improvement in recent years, reflecting the improvement of the credit rating of the Republic of Cyprus, namely the restoration of its credit rating to investment grade by S&P in September 2018 and by other Agencies in subsequent ratings. As shown in Figure 11 below, the increased share of the Hedge Funds in the May 2015 issue was followed by a significant contraction of this type of investors with the majority of them in the final distribution in the primary market coming from Fund Managers and Banks/Private Banks. At the last EMTN issuance, the majority of investors were Fund Managers, followed by Insurance/Pension Funds and Banks/Private Banks.

Figure 11: Investor allocation by type in the primary market (EMTN)

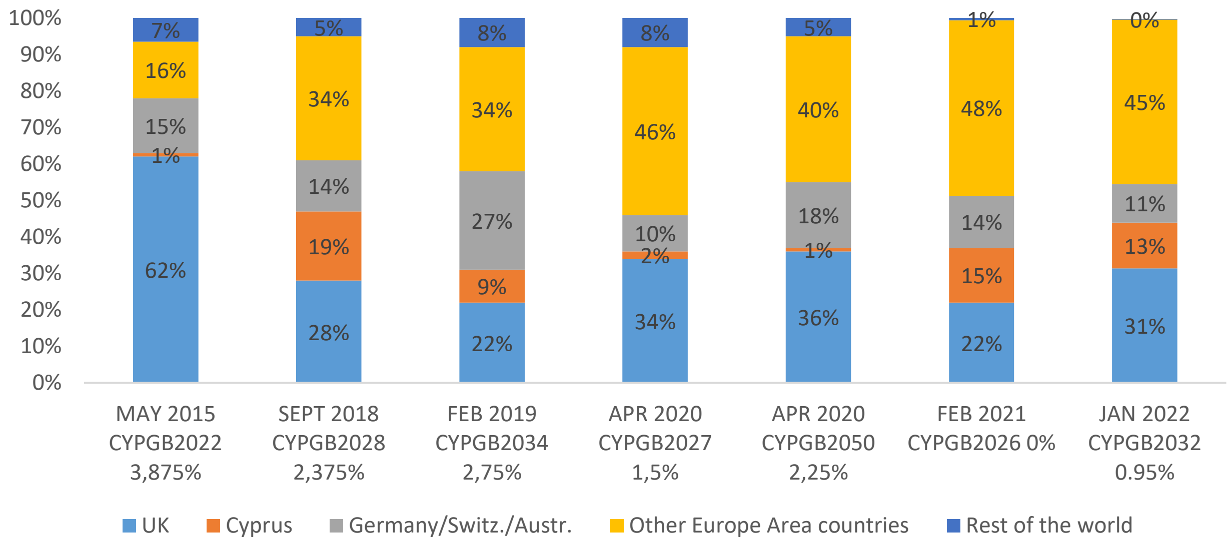


(Source: PDMO)

Note: This figure does not illustrate all the EMTN issuances.

Figure 12 below, illustrates the distribution of investors by geography for selected EMTN issuances during the period 2015 to 2022.The distribution of investors by geography shows a more balanced distribution between UK and Europe investors. However, investors from UK continue to play a significant role in the development of the orderbook at every EMTN issuance. During the last issuance an extended investor base by geography has been achieved across Europe with Cypriot investors having an important share on the final allocation. At the last issuance, the majority of the international investors originated from the UK and Nordic countries.

Figure 12: Investor allocation by geography in the primary market (EMTN)



(Source: PDMO)

Note: This figure does not illustrate all the EMTN issuances.

VI. Strategic Framework 2023-2025

A. Selected issuance strategy

The main financing tool for the aforementioned strategic period will be international bond issuances given the large size of the aforementioned market in order to continue with the progress made on the strategic targets of debt management over the past years.

These bonds are under English Law and listing may occur in more than one stock exchange. The method of issuance is through syndication.

All other available instruments will complement the international bond issuances. Domestic bonds, issued under Cyprus law and listed at the Cyprus Stock Exchange will be used to a lesser extent should opportunities arise. Additionally, the retail segment of the domestic market will be tapped in regular intervals through retail bonds. In the short-term spectrum, Treasury Bills and potentially, Commercial Papers will be used, giving priority to Treasury Bills issued through auctions. Finally, non-market financing will be pursued from supranational institutions for long-term financing either for new projects mainly associated to the green transition and digital transformation or ongoing projects. It is noted that within the reference period, the issuance of a sustainable bond will be proceeded in the context of financing either green and/or social projects.

The specific features of the newly assumed debt will be chosen in accordance with the guidelines set on risk management, development and expansion of the market and investor base, and under the condition that risk mitigation generally precedes cost minimization.

B. Guidelines and strategic objectives

B1: Risk mitigation

Reduction of Refinancing risk

Smoothening of the maturity profile has been the main focus of the MTDS concerning the period 2022-2024, leading to positive results. Efforts towards the same direction will also continue under the new strategy 2023-2025 so as to maintain a fairly balanced redemption schedule as well as an ample average remaining maturity profile in order to keep the refinancing risk at low levels. Nonetheless, the international bonds issued at a minimum benchmark size by small-scale issuers, such as the Republic of Cyprus, according to international best practice (at EUR 1 bn as a general rule) , cause rather sizeable remaining maturity peaks. Targets are set as follows:

(i) **Target: Maintaining average remaining maturity of marketable debt to 7 years minimum.**

Rationale: The reasoning for maintaining remaining maturity levels greater than 7 years is to enable the State to proceed with redesigning its strategy, if that be required, in order to ensure that borrowing is contained within acceptable and manageable risk levels. High concentration of debt with a medium-term horizon could undermine the objective of the public debt management especially given the high level of uncertainty that currently exists in public finances due to the unforeseeable economic consequences from the continuation of Russia-Ukraine war and the EU sanctions effects which seems likely to continue and from the possibility of a new wave of Covid-19 pandemic which seems likely to continue, although at a slower pace, in 2023 as well.

(ii) **Target: The outstanding short-term debt, with initial issuance maturity up to 12 months, will not exceed 3% of the cumulative government debt for each of the years 2023, 2024 and 2025.**

Rationale: Preserving short term debt within these levels ensures the minimization of refinancing cost and contains interest rate risk, particularly at times of strong interest rate volatility. At the same time, there should be sufficient room left for long term issuances in order to improve liquidity of Eurobond issuances and develop the long-term yield curve.

Principles/Actions: Regular auctions will be pursued, preceded by the publication of an auction calendar.

(iii) **Target: Maintaining adequate liquid funds to cover financing needs of the next 6-9 months, focusing on the maximum limit of 9 months for the period 2023 to 2025.**

Rationale: Substantial prudential liquidity allows more room for executing main financing operations in case unfavorable conditions disrupt or delay market access.

Principles/Actions: Cash management may be utilized to minimize the cost of carry.

(iv) **Target: The maturity of issuances will be chosen so that the annual gross financing needs do not exceed 10% of the respective GDP for the years up to 2030**.

Rationale: The target aims to ensure that financing needs are comfortably met under normal market conditions. According to the IMF risk assessment framework countries with gross financing needs up to 15% of GDP are assessed as 'low scrutiny'. A prudent limit is set for the case of Cyprus, to account for the lower liquidity in the market which can exacerbate investor behavior in times of market stress. It is noted that at recent issuances a growing investor base has been presented with high bid to cover ratios indicating the possibility of the State to proceed with an issuance volume of more than 10% of GDP.

Principles/Actions: Liability management transactions may be applied in order to comply with the strategy target.

(v) **Target: The difference between the average interest rate on public debt and the nominal GDP growth rate of the economy will maintain at negative values for the years 2023, 2024 and 2025**

Rationale: The target aims to ensure that the refinancing risk of the outstanding public debt will be maintained at the lowest level, the fiscal cost will be sustained at low levels and in general to eliminate risks to debt sustainability. Although, theoretical models do not provide clear cut and sufficient conclusions with respect to the sign and size of the interest rate-growth differential on government debt (i-g), the above target is set for the case of Cyprus, to account for the relatively elevated stock of public debt that raises Cyprus's vulnerability to interest rates, especially under the current level of the increasing interest rate environment. It is noted that maintaining negative interest rate-growth differential on government debt helps to stabilize debt in the long term, however debt dynamics in the near term depend also on the primary budget balance.

Principles/Actions: Amendment of the target of liquid funds may be applied in order to comply with the strategy target.

Interest rate risk

Following the borrowing of official loans under the EU-IMF Adjustment Programme in the period 2013-2016, the share of debt carrying floating interest rates increased significantly. While total floating rate debt has been following a declining path approaching 30% at the end of September 2022 given the early repayment of the IMF loan in February 2020, the floating rate debt is set to substantially decline as of 2025 onwards. This is expected to occur through the redemption of ESM loans that carry floating interest rate and through the assumption of long-term project loans with fixed interest rate (nominator effect).

Target: Debt carrying floating interest rates should not exceed 30% of outstanding debt in the period 2023 to 2025.

Rationale: This target aims at reducing fluctuations of interest paid on an annual basis due to floating interest rates. The share of debt with floating interest rate concerns mostly the ESM loans. Furthermore, this target aims to improve the forecasts of public finances and evidently government cash reserves. With respect to projects financed by loans, priority will be given to those carrying fixed interest rates within the next three-year horizon.

Principles/Actions: The use of derivatives will be assessed and may be applied to ensure compliance of the debt structure with the strategy. Priority will be given to fixed-interest loans in order to contribute positively to the target set under the strategy.

Foreign exchange risk

Cyprus has not issued long term marketable debt in foreign currency to date, with the exception of the IMF loan which has been prepaid in 2020. The fact is that the euro market is sufficiently large and diverse covering Cyprus' financing needs.

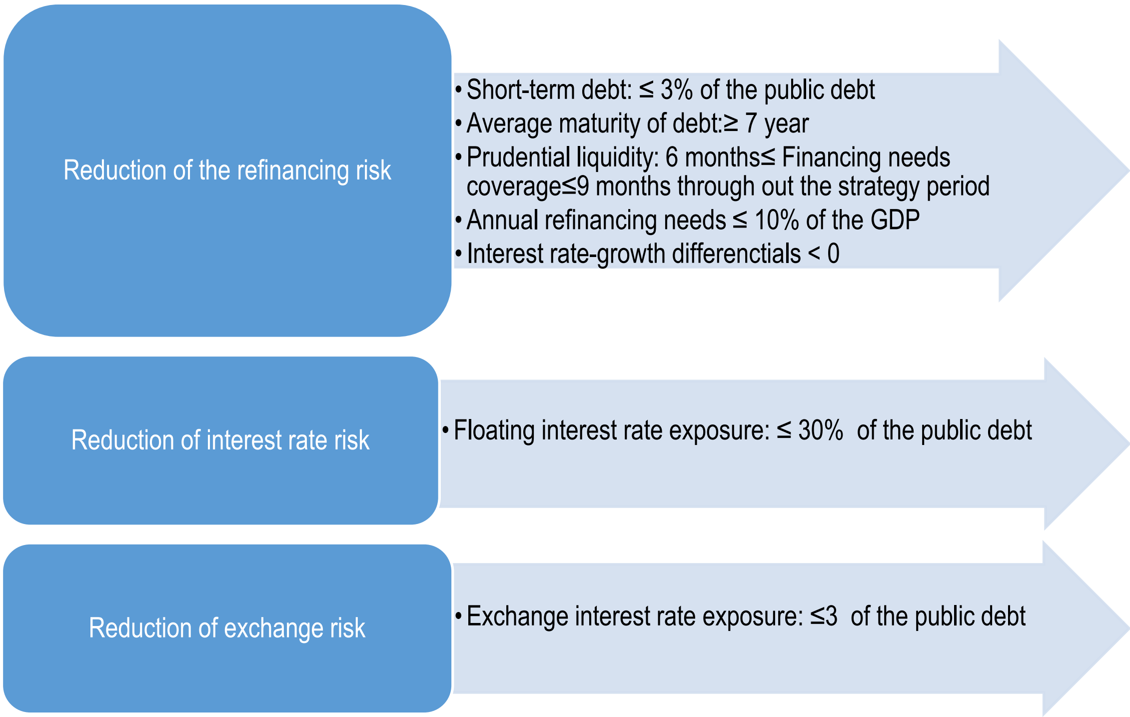
Target: Debt denominated in foreign currency should not exceed 3% of outstanding debt.

Rationale: While opportunities in foreign currencies may arise from time to time, these should be evaluated in relation to the development of the government securities market, mitigation of exchange risk and the objective of cost minimization.

Principles/Actions: The use of derivatives will be assessed and may be applied to ensure compliance of the debt structure with the strategy.

The strategic targets serve as benchmarks and are a management tool for the government to steer its risk tolerance with respect to refinancing and market risk. An overview of the key risk benchmarks is illustrated in Figure 13.

Figure 13: Key risk benchmarks for debt management 2023-2025



B2: Development of government securities market

Primary market

Background: The Cypriot sovereign debt market is naturally constrained by its small size therefore primary market activity is vital in maintaining the functioning of the market. However, market fragmentation has been reduced post economic crisis with the concentration of financing needs in single benchmark international bonds and absence from domestic bond issuances.

Target: The completion and extension of sovereign yield curve with international investors benchmark bond issuances.

Rationale: Significant improvement has been achieved in building up the sovereign yield curve which has been extended up to a 30-year tenor. However, the whole process for further enhancement is ongoing so that at any one point there are enough available pricing points to evaluate possible issuing opportunities.

Principles/Actions: Communication of general financing plans to the market and transparency, predictability and consistency of actions to the extent permitted by market conditions and major economic developments. Regular, benchmark-sized, issuance under the same instrument, the EMTN Programme. In this way, consistency of issuance characteristics in terms of currency and interest rate type is maintained.

Secondary market

Background: The promotion of a vibrant secondary market for government securities has proved to be one of the more difficult aspects of government securities market development. Successful development of the secondary market requires a number of actions such as active participation of many different groups, including investors, providers of trading and settlement infrastructure and intermediaries.

In the context of developing the government securities market, a primary dealer system based on best effort basis has been adopted by the PDMO and it seems that the efficiency of the secondary market for government bonds has increased during the last few years. The bank group comprises eight international banks with terms of reference, among others, to support a well-functioning market for the Cyprus government securities and display a good code of conduct in the clearing and settlement of trades, provide information about prices in the secondary markets, development via their marketing strategy new client investment in Cyprus Government securities and make them accessible to investors.

Following the formation of a bank group to support the Cyprus government bond market the management of relations with the financial institutions has become more formal. Additionally, with the introduction of MTS, an electronic trading platform, towards the end of 2019 secondary market transactions began to take place, thus enabling primary dealers to trade electronically and enhancing transparency and efficiency in the Eurobond market.

Target: A more liquid and transparent secondary market.

Rationale: A functioning secondary market, within the limitations of a small issuer, will strengthen demand in the primary market.

Principles/Actions:

i. A group of market-making banks acting as dealers in the secondary market, will initially be maintained within an underlying operational infrastructure on a voluntary basis. The performance of the banks will be evaluated and properly communicated. The assessment will take place during the strategy period in order to evaluate whether conditions are mature enough to proceed to a full primary dealership system.
ii. The investor support in the secondary market trading will be a driver for primary market allocation.
iii. Transparency in the processes and decisions, clear communication of privileges and obligations on behalf of the banks. Timely communication for the appraisal of the banks' activities.

B3: Investor relations

Background: Given the small and relatively infrequent debt issuances of Cyprus, when compared to the rest of the Eurozone, with the exception of the year 2020 when the Government issued six EMTN due to the high uncertainty surrounding the development of the Covid-19 pandemic, there is a need to counterbalance with actions that enhance visibility and presence in the market. In the last few years, efforts to increase visibility have intensified with regular roadshows in core and peripheral European financial centers, as well as the US east coast. The PDMO has expanded its list of investor entities to a multiple of the contacts a few years ago. Investor communication takes place through teleconferencing and through the PDMO's website, as well as through regular publications involving information on public debt management and economic developments in Cyprus.

Target: A larger, more diversified and less correlated pool of investors.

Principles/Actions:

i. Maintaining regular communication with existing investors whilst intensifying efforts to bring in new investors, in order to expand the investor base and the geographical distribution. Efforts for swift responses to opportunities with new investors as a result of credit rating or market changes will be aimed at. Overall, as broad an investor base as possible will be targeted.
ii. Communication with investors through:

- Regular publication of reports and statistics about the Cypriot economy and on debt management developments with the aim of facilitating the information spread on a regular basis (See Box)
- Roadshows and meetings with investors on a regular basis
- Participation of the PDMO in main international conferences and fora
- Maintenance of the stand-alone website and of a mailing list which investors can subscribe to.

Box: Disclosure of information to market participants

All publications are prepared by the Public Debt Management Office with the aim of maintaining information flow towards the investor community and international financial institutions. All publications are posted on the PDMO website.

Medium Term Public Debt Management Strategy
Designed on a three-to-five-year basis, provides the outline of government policy for financing and public debt related matters, projected gross financing needs and the desired cost-risk outcome of the debt portfolio. It is approved by the Council of Ministers through submission by the Minister of Finance.

Annual Funding Plan
For every fiscal year, the PDMO prepares an Annual Funding Plan which covers the projected accumulated borrowing needs of the Republic of Cyprus.

Annual Public Debt Management Report
Communicated by the Minister of Finance to the Budget and Finance Committee of the Parliament, it includes the following:

- Developments in Cypriot and eurozone capital markets
- Debt structure
- Debt operations of the year in review
- Risk management and risk indicators
- Review of annual actions and operations towards MTDS targets

Auction Calendar
Calendar for monthly Treasury Bill auctions published twice in a year.

Quarterly debt bulletin
Overview of the quarterly debt management operations, auction results, secondary market yield developments and main statistics, compared to previous quarters.

Quarterly statistics
Lists concerning the central government debt by instrument and the maturity profile.

Bi-annual risk indicators
Time series of main indicators for refinancing, currency and interest rate risk.

Newsletter on economic developments
Main events and data on all recent developments in the macro economy, banking, fiscal and public debt management of Cyprus. Published at least quarterly.

Investor Presentation
Published frequently, it includes the latest information and forecasts on the macro economy, public finances, financial sector and public debt management.

Offering Circular
The PDMO is updating the Offering Circular, which is a part of the EMTN legal documents and includes important provisions about the EMTN programme as well as information and data of the Republic of Cyprus and economy.

C. Comparison with the MTDS 2022-2024

The main pillars for MTDS 2023-2025 remain the same as those of the previous strategy, as their consistent implementation has obviously contributed to achieving the objective of public debt management. The chosen strategy for the period 2023-2025 corresponds and is based on the benchmarks achieved during the previous period.

For the refinancing risk reduction guideline, five quantitative targets were set. The target for the short-term debt was maintained at the same level compared to the existing strategy and should not exceed 3% of the total outstanding debt for the period 2023-2025. The second quantitative target, concerns the average remaining maturity of marketable debt. In view of the fact that the main source of financing for the coming years will be the international bond market through the issuance of EMTN, retaining the average remaining maturity of the marketable debt at not less than 7 years, acquires special importance in combination with the next quantitative indicator that refers to the reduction of the gross financing needs to below 10% of GDP by the end of 2030. The fourth quantitative target, which is one of the most important indicators for the reduction of the refinancing risk, in view also of the continuation of the Russia-Ukraine war for an unknown period as well as of a possibility of a new wave of the Covid-19 pandemic in the near future, is to retain cash reserves at the same level as it is in the existing strategy, covering the financial needs of the next 6 -9 months (with more emphasis to 9 months). The reason that the target remains the same, is attributed to the uncertainty in the global economy, the continuation of inflationary pressures as well as the possibility of a new wave of Covid-19 pandemic. In addition, a new target about interest rate-growth differential has been incorporated in the new MDTS to eliminate, among other factors, the risks on debt sustainability.

The guideline for the development of the public debt market includes two objectives, which were also incorporated in the MTDS 2022-2024. The first objective concerns the development of the primary market of government securities and the second objective focuses on the development of the secondary market with higher liquidity and transparency. In the field of the secondary market, the intended efforts will concern the continuation of the evaluation of the work carried out by the group of international banks in order to increase the efficiency of the secondary market and the evaluation of the operation of the electronic trading platform of Cypriot government bonds and its contribution in the increase of the liquidity of the bonds of the Republic of Cyprus.

In general, the guidelines on investor relations remain the same. PDMO will continue to seek regular contact with existing investors, while trying to find new investors in order to achieve a more diversified and a less correlated investment base contributing to the further reduction of transaction costs.

D. Potential risks in the implementation of the Strategy

Although the credit rating developments for the Republic of Cyprus were positive during the year 2022, with two Credit Rating Agencies upgrading the sovereign bond rating of Cyprus by one notch (to “BBB”) and one other CRA affirming the sovereign bond rating of Cyprus and changing the outlook from stable to positive, uncertainty in the global economy remains high. If the war’s effects will lead in materially weaker economic growth prospects or fiscal consolidation interrupting the downward path of the public debt, then a negative rating action would be a possible scenario. It is worth noting that any change in the outlook and/or investment rating category or even non-investment rating will have an impact on the cost of borrowing of the Republic of Cyprus.

In addition, a possible increase in the annual gross financing needs due to the continuation of the Russia-Ukraine war, impacts of EU sanctions and inflationary pressures on Cypriot economy as well as a possible new wave of Covid-19 pandemic may affect the amount of capital borrowed from international markets and borrowing within an acceptable and manageable risk framework. Consequently, this may necessitate the raising of funds from the domestic market with probably higher borrowing costs and a negative impact on effective demand and purchasing power.

Although it seems unlikely to have a material negative impact at this stage, the possibility of a prolonged period of increased interest rates, may affect the cost of borrowing and therefore the cost of servicing the public debt.

VII. Final provisions

The PDMO may deviate from the Strategy, with the approval of the Minister of Finance, if significant market conditions or economic developments render it a necessary or appropriate action. Although the Strategy allows for some flexibility, accountability and transparency of action and decision-making will be pursued at the same time.

With the adoption of the Strategy for 2023-2025, the MTDS 2022-2024 becomes void.

Annual Financing Plan 2022

Financing Instrument	Initial AFP_2022 (Nov. 2021) Borrowing range/ limits (a)	First Revised AFP_2022 (May 2022) Borrowing range/ limits (b)	Change (b) – (a)
Domestic 3-month Treasury Bills	€300 mn	€300 mn	€0 mn
Euro Medium Term Notes (EMTN)	€1500 mn	€1000 mn	(€500 mn)
Domestic Retail Bonds	€40 mn	€40 mn	€0 mn
Loans from Supranational Institutions (EIB, EBRD, CEB)	€124 mn	€124 mn	€0 mn
Use of cash buffer	€497 mn	€637 mn	€140 mn
Total approved maximum borrowing amount in Jan. ~ Dec. 2022	**€2461 mn**	**€2101 mn**	**(€360 mn)**

Note: EIB = European Investment Bank, EBRD = European Bank for Reconstruction and Development, CEB = Council of Europe Development Bank, amounts in (…) indicate a reduction.

- An amount of EUR 170 mn in grants under the RRF is expected to be received until the end of the year.
- A second top up under the SURE instrument (to mitigate Unemployment Risks in an Emergency) of the order of EUR 29 mn is expected to be disbursed until the end of the year.